

STATE OF MINNESOTA  
OFFICE OF ADMINISTRATIVE HEARINGS  
FOR THE COMMISSIONER OF COMMERCE

In the Matter of the Real Estate  
Salesperson License of  
Becky J. Engstrom, License No. 507668  
and Real Estate Brokers License of  
Burnet Realty, Inc., License No.  
146677.

**FINDINGS OF FACT,  
CONCLUSIONS, AND  
RECOMMENDATION**

The above-entitled matter came on for hearing before Administrative Law Judge Bruce H. Johnson at 9:30 a.m. on Monday, August 18, 1997, at the Minnesota Department of Commerce, 133 East Seventh Street, St. Paul, Minnesota.

Michael A. Sindt, Assistant Attorney General, Suite 1200 NCL Tower, 445 Minnesota Street, St. Paul, Minnesota 55101-2130, appeared on behalf of the Minnesota Department of Commerce (hereinafter the "Department"). Richard A. Lind, Attorney at Law, 150 South Fifth Street, Suite 1700, Minneapolis, Minnesota 55402, appeared on behalf of the Respondents, Becky J. Engstrom and Burnet Realty, Inc. (hereinafter "Ms. Engstrom" and "Burnet," respectively). During the course of the hearing, there was a tape recorder malfunction, as a result of which the initial portions of the direct examination of Thomas L. Rehman were lost. By stipulation approved on October 24, 1997, the parties agreed on the substance of all but one of the lost portions of Mr. Rehman's direct examination. The parties submitted proposals regarding their recollections of the remaining portion and agreed that the Administrative Law Judge should make a finding thereon in accordance with his own recollection. The record closed on October 24, 1997, upon approval by the Administrative Law Judge of the parties' stipulation regarding Mr. Rehman's lost testimony.

**NOTICE**

This Report is a recommendation, not a final decision. The Commissioner of the Minnesota Department of Commerce will make the final decision after a review of the

record. The Commissioner may adopt, reject or modify the Findings of Fact, Conclusions, and Recommendations. Under Minn. Stat. § 14.61, the final decision of the Commissioner shall not be made until this Report has been made available to the parties to the proceeding for at least ten days. An opportunity must be afforded to each party adversely affected by this Report to file exceptions and present argument to the Commissioner. Parties should contact David B. Gruenes, Commissioner, Department of Commerce, 133 East Seventh Street, St. Paul, Minnesota 55155, to ascertain the procedure for filing exceptions or presenting argument.

### **STATEMENT OF THE ISSUES**

The issues to be determined in this proceeding are:

1. Whether Ms. Engstrom engaged in fraudulent, deceptive, and dishonest practices or has, in the conduct of her affairs under her real estate salesperson's license, been shown to be incompetent, untrustworthy, or financially irresponsible in violation of Minn. Stat. § 82.27, subd. 1(b) and (f) (1996), Minn. R. 2805.2000, subp. 1. I. and J. (1995), and Minn. R. 2805.1400, subp. 3 (1995).

2. Whether Ms. Engstrom permitted or allowed certain sellers of real property, whom she represented as a real estate agent, to misrepresent the condition of the septic system on their property and, thereby, engaged in fraudulent, deceptive, and dishonest practices or has, in the conduct of her affairs under her real estate salesperson's license, been shown to be incompetent, untrustworthy, or financially irresponsible in violation of Minn. Stat. § 82.27, subd. 1(b) and (f) (1996) and Minn. R. 2805.2000, subp. 1. I. and J. (1995).

3. Whether, as Ms. Engstrom's real estate broker, Burnet failed to supervise her conduct and allowed her or others to make a material misrepresentation so as to cause injury or harm to the public in violation of Minn. Stat. § 82.27, subd. 1(d) (1996) and Minn. R. 2805.2000, subp. 1. I. and J. (1995).

### **FINDINGS OF FACT**

1. At all times material to this proceeding, Burnet was a Minnesota corporation duly licensed by the Minnesota Commissioner of Commerce (hereinafter the "Commissioner") as a real estate broker. Burnet owned and operated a real estate sales and brokerage business at forty locations in the State of Minnesota, including the City of Stillwater. (Tr. pp. 287-293)

2. At all times material to this proceeding, Ms. Engstrom was duly licensed by the Commissioner as a real estate salesperson. (Exhibit 14) She was associated with Burnet as an independent contractor and real estate agent for Burnet and worked out of Burnet's Stillwater office. (Tr. pp. 25, 304-305) Burnet provided Ms. Engstrom

with supervision through one of Burnet's managers, to whom Ms. Engstrom was accountable in her conduct of business on behalf of Burnet. (Tr. pp. 288-293)

3. At all times material to this proceeding, Edina Realty, Inc. (hereinafter "Edina") was a Minnesota corporation duly licensed by the Minnesota Commissioner of Commerce (hereinafter the "Commissioner") as a real estate broker. Edina also owned and operated a real estate sales and brokerage business at various locations in the State of Minnesota, including the City of Stillwater. (Tr. p. 218)

4. Burnet provided Ms. Engstrom and the other real estate agents associated with Burnet with training and guidance throughout the period of their association, including information about changes in laws pertaining to the real estate profession. (Tr. pp. 257, 288-296) This included training relating to Minn. Stat. § 115.55 (1996) which deals with, among other things, disclosure of information about private sewer systems. (Tr. p. 268; Item 1 of Stipulation approved on October 24, 1997 (hereinafter "Stipulation"))

5. At all times material to this proceeding, William Pyszka, Katie Daniels, and Patricia Branch were all duly licensed by the Commissioner as either real estate salespersons or brokers. Mr. Pyszka and Ms. Daniels were either employed or otherwise affiliated with Edina as real estate agents and worked out of Edina's Stillwater office. Ms. Branch was employed or otherwise affiliated with Edina as sales manager at its Stillwater office. (Tr. pp. 127-128, 210, 218-19)

6. For some period of time prior to July 25, 1996, Kelly and Alane Stickans (hereinafter the "Stickans") were the owners of certain real property located at 274 Quinlan Avenue North, Lakeland, Minnesota (hereinafter the "Lakeland property"). In about May of 1996, the Stickans decided to sell the Lakeland property and entered into a listing agreement with Edina real estate agent Katie Daniels. Acting on behalf of the Stickans, Ms. Daniels subsequently listed the Lakeland property for sale. (Tr. pp. 26-39)

7. At some time prior to July 25, 1996, Erik and Lisa Munkeby (hereinafter the "Munkebys") entered into an agreement for Burnet and Ms. Engstrom to assist and represent them as buyers' agents in connection with the purchase of real property in the Stillwater area. (Tr. pp. 26-29; 85) Ms. Engstrom brought the Lakeland property to the Munkebys' attention, and they subsequently entered into negotiations with the Stickans for purchase of that property. (Tr. pp. 26-29, 85-88)

8. In connection with the purchase negotiations between the Stickans and the Munkebys, Edina and the Stickans submitted to the Munkebys an Edina Realty private sewer system disclosure form (Exhibit E) dated May 24, 1996. On line 50 of that form, the Stickans expressly represented to the Munkebys that there were no known defects in the sewer system.

9. Before providing the Munkebys with financing for their purchase of the Lakeland property, their lender required them to obtain a sewer system condition report from an MPCA-certified inspector in addition to the private sewer system disclosure form that had been provided to them by the Stickans. (Tr. pp. 109-110) The Munkebys contracted with Jack Gill to have him perform the inspection and to prepare a report detailing the results of his inspection. (Tr. pp. 29-30, 109-110; Exhibit D)

10. On June 15, 1996, Mr. Gill conducted an inspection of the private sewer system on the Lakeland property and issued a report of his inspection (Exhibit D), copies of which were provided to the Munkebys, Ms. Engstrom, the Stickans, and Katie Daniels. Mr. Gill summarized the results of his inspection as follows:

I have inspected the septic system and reviewed the history of the system with the owner, Alane Stickan. I have also performed a "MPCA compliance inspection", which is attached. The septic tank and drywell should be pumped in the near future. The septic tank baffles should be checked at the time of pumping, as the liquid level of the septic tank appears to be quite high indicating possible baffle problems. This is a very, very old septic system which may require some upgrading in future years. Pumping the septic tank at least once a year may help to extend the life of the system.

Predicated on my inspection of the system and my review of the history of the system of the owner, it is my opinion that this is a "working and functioning" system. However, this system is in non-compliance with MPCA rules 7080 Subp. 16a because of the existing drywell. This system is not an imminent threat to public health or safety per MPCA rule 7080 Subp. 19a.

In accordance with MPCA rules I am sending a copy of this complete report to the City of Lakeland. I have discussed similar systems with the City of Lakeland (Phone # 436-4430) and have been advised that the City of Lakeland is not at this time requiring replacement of failing systems unless the system is an imminent threat to public health or safety, which this system is not. However, I advise contacting the City to verify the City's position. [Emphasis supplied by author of the document.]

11. In considering the purchase of the Lakeland property, the Munkebys contemplated building an addition on the house that would have included another bedroom and bathroom. (Tr. p. 87) Mr. Gill advised Mr. Munkeby that if he and his wife were ever to add a bedroom and bathroom to the Lakeland property, they might have to upgrade the septic system. (Id.) So, in negotiating with the Stickans to purchase the Lakeland property, the Munkebys requested that some financial accommodation be made by the Stickans toward a future upgrade of the septic system. (Tr. pp. 30, 86-87; Exhibits 11 and 12)

12. In an Amendment to Purchase Agreement dated July 16, 1996, the Stickans agreed to contribute an additional \$2,000 toward the Munkebys' closing costs

"in lieu of participating in the cost of the septic system upgrade or replacement." (Exhibit 12) The Munkebys eventually purchased the Lakeland property, and the final purchase agreement included those terms. (Tr. pp. 36-40, 110-111)

13. While the Munkebys resided in the Lakeland property, they experienced no problems with the operation of their septic system. (Tr. p. 90)

14. About a month and a half after the Munkebys moved into the Lakeland property, Mr. Munkeby's place of business was relocated to Lake Minnetonka, which involved a much longer commuting distance for him from their new home in Lakeland. Because of this change, the Munkebys decided to sell the Lakeland property and move to a home that was closer to Mr. Munkeby's place of business. (Tr. pp. 40, 88)

15. On or about October 2, 1996, the Munkebys entered into a listing agreement with Burnet and Ms. Engstrom under the terms of which the latter agreed to assist and represent the Munkebys in selling the Lakeland property. (Exhibit 9, Tr. pp. 40-41) Among the steps taken by Ms. Engstrom to sell the property was listing it in the local MLS computer. (Tr. p. 128) In response to that listing, Ms. Engstrom received inquiries from real estate agents acting on behalf of prospective buyers. Among these was an inquiry received by Ms. Engstrom just a few days after the property came on the market from Mr. Pyszka and Edina, who were acting on behalf of Theodore and Joette Karlson (hereinafter the "Karlsons"). (Tr. pp. 42, 128)

16. On or about October 10, 1996, Mr. Pyszka took the Karlsons to view the Lakeland property. Ms. Engstrom was not present when the Karlsons viewed the property. After seeing the property, the Karlsons informed Mr. Pyszka that they were interested in purchasing it. Mr. Pyszka indicated to them that he would prepare a written purchase agreement and have them sign it. (Tr. pp 129-130) Mr. Pyszka also told the Karlsons that he needed to see disclosure statements signed by the Munkebys, including a private sewer system disclosure statement. (Tr. p. 130)

17. Later on October 10, 1996, Mr. Pyszka called Burnet's Stillwater office in order to obtain the disclosure statements. Ms. Engstrom's was unavailable, so Mr. Pyszka talked to Ms. Engstrom's assistant. The assistant indicated that Ms. Engstrom was not expected in the office because her daughter was getting married that weekend; she also told Mr. Pyszka that the disclosure statements pertaining to the Lakeland property were unavailable at that time and that Burnet would forward them to Mr. Pyszka later. (Tr. p. 130)

18. On October 10, 1996, at about 5:40 p.m., Ms. Engstrom's assistant faxed three documents to Mr. Pyszka, namely: a copy of the private sewer system disclosure statement which the Stickans had prepared on May 15, 1996, in connection with their sale of the Lakeland property to the Munkebys (Exhibit E); a seller's property disclosure statement prepared and signed by the Munkebys (Exhibits B and 8); and a map depicting the house, the septic tank, and the drywell. (Tr. pp. 175-177) Prior to

that time on October 10th, Mr. Pyszka had not had any direct telephone contact with Ms. Engstrom. (Id.)

19. Sometime between October 1st and 10th, 1997, the Munkebys completed the seller's property disclosure statement that was faxed to Mr. Pyszka on October 10, 1996. (Exhibits 6 and B) On line 120 of that particular disclosure statement the Munkebys indicated that there were no known defects in or on the property. (Id.) Ms. Engstrom was not present when the Munkebys completed that disclosure statement, nor did she assist them in completing it, except to tell them to complete it to the best of their knowledge. (Tr. pp. 47, 54-56) Ms. Engstrom did not see the Munkebys' seller's property disclosure statement before it was faxed to Mr. Pyszka.

20. Sometime after he received the May 15, 1996, private sewer system disclosure statement, Mr. Pyszka contacted either Ms. Engstrom or her assistant and requested a new private sewer system disclosure statement signed by the Munkebys as sellers. (Tr. pp. 132-133)

21. After some unsuccessful attempts, Mr. Pyszka finally made telephone contact with Ms. Engstrom herself late in the day on October 10, 1997. Mr. Pyszka indicated to her that he had prospective buyers that were interested in purchasing the Lakeland property and that he would be drafting a proposed written purchase agreement. (Tr. pp. 43, 131-132) Ms. Engstrom explained that her daughter was getting married that weekend and that she would only be in a position to engage in verbal negotiations until the following week. (Tr. p. 43)

22. During the course of the telephone conversation described in Finding of Fact No. 21 or some later telephone conversations on October 10, 1996, Mr. Pyszka communicated to Ms. Engstrom a verbal offer on behalf of the Karlsons to purchase the Lakeland property. (Tr. p. 43, 307) Mr. Pyszka drafted a written purchase agreement and supporting documents on behalf of the Karlsons and had them sign those documents sometime on October 10, 1996. (Tr. pp. 130, 136-140) Neither the original nor any copy of that proposed purchase agreement was transmitted to Burnet, Ms. Engstrom, or the Munkebys. (Tr. pp. 44, 107, 167-175; Exhibit J)

23. Sometime on October 10, 1996, Ms. Engstrom left Mr. Pyszka a voice mail message advising him that Jack Gill had performed an inspection of the septic system on the property in connection with the Munkebys' purchase of the property in July of 1996 and had prepared a report indicating that the system was in working order but was "nonconforming." (Tr. pp. 44, 186, 215-216, and 327; Exhibits G and 10) Mr. Pyszka understood the term "nonconforming" to mean that the septic system was not in compliance with applicable statutes or rules. (Tr. pp. 214-215) Ms. Engstrom told Mr. Pyszka that she would be making arrangements to forward a copy of Mr. Gill's report to him. (Tr. pp. 44, 123, 327)

24. After his October 10, 1996, telephone conversation with Ms. Engstrom regarding Mr. Gill's report, Mr. Pyszka called Mr. Gill on the same day or evening. Mr.

Gill communicated the details of his inspection and findings to Mr. Pyszka over the telephone. (Tr. p. 134) Later, Mr. Gill transmitted a copy of his report to Mr. Pyszka by fax. (Tr. p. 135)

25. Edina real estate agent Katie Daniels had received a copy of Mr. Gill's report in June of 1996 when she was representing the Stickans in connection with the sale of the property from the Stickans to the Munkebys. (Tr. p. 226) At some time on October 10, 1996, Mr. Pyszka discussed Mr. Gill's report with Ms. Daniels. (Tr. p. 184)

26. On the morning of October 11, 1996, the Munkebys completed and signed, as sellers, a private sewer system disclosure statement on the Lakeland property (Exhibit 8). Ms. Engstrom told the Munkebys to complete the forms to the best of their knowledge, but she was not present when they completed the forms and did not assist them in filling them out. (Tr. pp. 47, 54-56) The Munkebys either faxed it directly to Mr. Pyszka or to Ms. Engstrom's assistant who, in turn, faxed it to Mr. Pyszka. (Tr. p. 93) The Munkebys mailed the original private sewer system disclosure form to Ms. Engstrom, who did not receive and actually see it until some later date. (Tr. p. 48) Mr. Pyszka received a faxed copy of the Munkebys' private sewer system disclosure form on October 11, 1996, at 8:31 a.m. (Tr. pp. 91-92, 180-181; Exhibit A) On line 50 of their private sewer system disclosure statement, the Munkebys indicated that there were no known defects in the system. (Exhibit A and 8)

27. After receiving the Munkebys' private sewer system disclosure form on the morning of October 11, 1996, Mr. Pyszka discussed it and the contents of Mr. Gill's report with the Karlsons. The Karlsons told Mr. Pyszka that they wished to withdraw their offer. Sometime during the period October 11-13, Mr. Pyszka called Ms. Engstrom and left a voice mail message indicating that the Karlsons were no longer interested in the Lakeland property and were withdrawing their offer. (Tr. pp. 53, 309)

28. Mr. Pyszka subsequently transmitted a fax to Ms. Engstrom, asking her to correct what he considered to be discrepancies on line 50 of the private sewer system disclosure form and line 119 of the property disclosure form. He cited discrepancies on those forms as the reason for the Karlsons' withdrawal of their offer. (Exhibit G) Mr. Pyszka sent a similar fax to Ms. Engstrom's manager at Burnet. (Exhibit 16) Ms. Engstrom and her manager refused to make corrections to the Munkebys' private sewer system disclosure form based on their belief that the decision whether to make corrections was the sellers' alone, and that their duty as real estate agents to disclose material facts was independent of the sellers'. (Tr. pp. 58-61, 269)

29. Before the enactment of Minn. Stat. § 115.55, subd. 6 (1996), Burnet developed its own private sewer system disclosure statement form and distributed copies of that form to its affiliated real estate agents for use in real estate transactions in which they were involved. (Stipulation, Item 2) It has been Burnet's position that those disclosure forms represent statements made by the actual sellers of real property but not statements attributable to the real estate agents or salespersons who may represent those sellers. It is further Burnet's position that an agent's obligations to make

disclosures concerning septic systems are separate and independent of the seller's obligations to make such disclosures, and that an agent is obligated to make disclosure of any material facts about the property at some time before a fully executed purchase agreement – that is, a purchase agreement that binds someone to perform – comes into existence. (Stipulation, Items 3 and 4)

30. Burnet instructs all of its real estate agents to tell the sellers of real property which Burnet represents to complete all forms relating to a prospective sale, including Private Sewer System Disclosure Forms, truthfully and honestly. (Stipulation, Item 5)

31. Mr. Rehman, testifying on behalf of Burnet, stated that there are times when the duty to disclose material facts about a property must be reconciled with a real estate agent's obligation to maximize marketing of the property for his or her principal. Such situations occur, for example, when material facts may be emotionally charged or misleading to a buyer. Examples given by Mr. Rehman were when a violent death or suicide has occurred in a home or where a landfill is located nearby. Mr. Rehman testified further that rather than disclose such facts in the initial marketing material concerning the property and possibly prejudicing prospective buyers from the outset against purchasing the property, Burnet recommends that its agents advise buyers' agents to inquire further about additional material facts concerning the property.<sup>[1]</sup>

32. Sometime prior to February 24, 1994, Mr. Pyszka filed a complaint against Ms. Engstrom with the Ethics Hearing Panel of the Minnesota Association of Realtors. (Exhibit G) In a decision dated February 24, 1994, the Hearing Panel concluded that Ms. Engstrom "did not conceal pertinent facts relating to the property and, therefore, was not in violation of Article 2 of the Code of Ethics." (Exhibit 5)

33. On October 18, 1996, Mr. Pyszka faxed a complaint against Ms. Engstrom and Burnet to the Minnesota Department of Commerce. (Exhibit 10) On October 25, 1996, the Department sent a letter to Ms. Engstrom forwarding a copy of Mr. Pyszka's complaint and requesting that she respond to the allegations and forward to the Department a copy of her entire file relating to the transaction in question. (Exhibit 13) Ms. Engstrom responded to the Department's request by letter dated November 4, 1996. (Exhibit 4)

34. Any Finding of Fact more properly termed a conclusion is hereby adopted as such.

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

### **CONCLUSIONS**



1. The Minnesota Commissioner of Commerce and the Administrative Law Judge have subject matter jurisdiction herein pursuant to Minn. Stat. §§ 82.27 and 14.50 (1996).

2. Ms. Engstrom and Burnet were given timely and proper notice of the hearing in this matter.

3. The Department has complied with all relevant substantive and procedural requirements of statute and rule.

4. At all times material to this proceeding, Ms. Engstrom was licensed by the Commissioner as a real estate salesperson pursuant to Minn. Stat. § 82.20 (1996).

5. At all times material to this proceeding, Burnet was licensed by the Commissioner as a real estate broker pursuant to Minn. Stat. § 82.20 (1996).

6. The finding by Mr. Gill that “the liquid level of the septic tank appears to be quite high indicating possible baffle problems” was not a material fact relating to the septic system on the Lakeland property.

7. On October 10, 1996, Ms. Engstrom disclosed to Mr. Pyszka, who was acting as agent for the Karlsons, all material facts relating to the condition of the septic system on the Lakeland property.

8. The private sewer system disclosure statement prepared and signed by the Munkebys in connection with the transactions described in the Findings of Fact did not conform to the requirements of Minn. Stat. § 115.55, subd. 6 (1996), but neither Ms. Engstrom, Burnet nor the Munkebys violated the provisions of that statute as they relate to disclosure of individual sewage treatment systems to buyers of real property.

9. In connection with the transactions described in the Findings of Fact, Ms. Engstrom did not engage in any fraudulent, deceptive, and dishonest practices in violation of Minn. Stat. § 82.27, subd. 1(b) (1996).

10. In connection with the transactions described in the Findings of Fact, Ms. Engstrom has not, in the conduct of her affairs under her real estate salesperson's license, been shown to be incompetent, untrustworthy, or financially irresponsible in violation of Minn. Stat. § 82.27, subd. 1(f) (1996).

11. In connection with the transactions described in the Findings of Fact, Ms. Engstrom did not make any material misrepresentations in violation of Minn. R. 2805.2000, subp. 1. I. and J. (1995) and Minn. Stat. § 82.27, subd. 1(b) (1996).

12. In connection with the transactions described in the Findings of Fact, Ms. Engstrom did not permit or allow another to make any material misrepresentations or

any false or misleading statements in violation of Minn. R. 2805.2000, subp. 1. I. and J. (1995) and Minn. Stat. § 82.27, subd. 1(b) (1996).

13. In connection with the transactions described in the Findings of Fact, Ms. Engstrom did not make any false or misleading statements of a character likely to influence, persuade, or induce the consummation of a transaction contemplated by Minn. Stat. ch. 82 in violation of Minn. R. 2805.2000, subp. 1. J. (1995) and Minn. Stat. § 82.27, subd. 1(b) (1996).

14. In connection with the transactions described in the Findings of Fact, Ms. Engstrom did not permit or allow another to make any material misrepresentations or any false or misleading statements of a character likely to influence, persuade, or induce the consummation of a transaction contemplated by Minn. Stat. ch. 82 in violation of Minn. R. 2805.2000, subp. 1. I. and J. (1995) and Minn. Stat. § 82.27, subd. 1(b) (1996).

15. In connection with the transactions described in the Findings of Fact, as Ms. Engstrom's real estate broker, Burnet did not fail to supervise her conduct and allowed her or others to make a material misrepresentation so as to cause injury or harm to the public in violation of Minn. Stat. § 82.27, subd. 1(d) (1996) and Minn. R. 2805.2000, subp. 1. I. and J. (1995).

16. Citation to exhibits or testimony in the foregoing Findings of Fact does not mean that all testimony or exhibits that support each Finding have been cited.

17. These Conclusions are made for the reasons set out in the Memorandum which is attached to and incorporated by reference in these Conclusions.

18. Any Conclusion more properly termed a Finding is hereby adopted as such.

Based upon the foregoing Conclusions, and for the reasons set forth in the accompanying Memorandum, the Administrative Law Judge makes the following:

### **RECOMMENDATION**

IT IS HEREBY RECOMMENDED: that no disciplinary action be taken against Respondents or their real estate salesperson and broker licenses and that no civil penalties be imposed upon them.

Dated this 6th day of November 1997.

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BRUCE H. JOHNSON  
Administrative Law Judge

Reported: Tape Recorded (four tapes); transcript prepared

### **NOTICE**

Pursuant to Minn. Stat. § 14.62, subd. 1, the Department is required to serve its final decision upon each party and the Administrative Law Judge by first-class mail.

## **MEMORANDUM**

This proceeding was initiated by a Notice of and Order for Hearing and Order to Show Cause dated May 22, 1997. The Department subsequently amended that Notice and Order three times, with the last amendment being served on August 18, 1997, the date of the hearing. The Department's claims against the Respondents all arise out of a single, unconsummated real estate transaction that occurred in October of 1996. The Munkebys owned a residence in the City of Lakeland, which they decided to sell. There was a septic system on the Munkebys' property which did not conform to the requirements of rules promulgated by the Minnesota Pollution Control Agency (hereinafter "MPCA"). The Munkebys engaged Ms. Engstrom and Burnet to act as their agents to list the property for sale and represent them in negotiations with prospective buyers. In connection with certain of those negotiations, the Department alleges that Ms. Engstrom failed to disclose to prospective buyers (the Karlsons) and their real estate agents (Mr. Pyszka and Edina) the condition of the septic system and therefore engaged in fraudulent, deceptive and dishonest practices in violation of certain Minnesota statutes and rules. The Department also contends that Ms. Engstrom allowed the Munkebys to misrepresent and make false statements about the condition of the septic system on their property in certain disclosure statements that were provided to Mr. Pyszka and Edina and, therefore, violated certain Minnesota statutes and rules. Finally, the Department contends that by allowing Ms. Engstrom to conduct herself in the ways alleged, Burnet failed to exercise reasonable supervision over her in violation of Minnesota statutes and rules.

By way of defense, the Respondents contend that Ms. Engstrom did make timely disclosure of all material facts pertaining to the septic system on the Munkebys' property. The Respondents concede that the written disclosure statements executed by the Munkebys contained no references to defects in, or nonconformities of, their septic system. They argue, however, that the duty to disclose embodied in those statements is the sellers' alone. Although a real estate agent may have a similar duty to disclose, that duty is separate and independent of the seller's duties. The Respondents argue that even if the Munkebys are deemed to have failed in their duty, Ms. Engstrom made an independent disclosure of the condition of the septic system and therefore met her duty. Finally, the Respondents contend that since Ms. Engstrom did not engage in any conduct that violated any pertinent statutes or rules, Burnet did not fail in its duty to supervise her.

### **MPCA's Individual Sewage Treatment Systems Program**

Minn. Stat. § 115.55, subd. 3 (1996) empowers the MPCA to "adopt rules containing minimum standards and criteria for the design, location, installation, use, and maintenance" of private septic systems. Minn. R. pt. 7080.0600, subp. 3 (1995) provides in part that "[i]ndividual sewage treatment systems shall be considered in compliance if . . . A. an existing individual treatment system is not a failing system as defined in part 7080.0020, subpart 16a." The latter rule defines a "failing system" as,

among other things, “any system that discharges sewage to a . . . drywell . . .” Even though a private septic system may be a failing system and noncompliant, Minn. R. pt. 7080.0600, subp. 4 (1995) does not require it to be “upgraded, replaced, repaired in compliance with this part, or discontinued” unless “a compliance inspection indicates that a system presents an imminent threat to public health or safety . . . .”

When the Munkebys were negotiating for the purchase of the property in question, they received a written private sewer system disclosure statement from the Stickans that indicated there were no known defects in the sewer system. (Exhibit E) The Munkebys’ lender, however, required them to obtain an inspection of the septic system before it made a financial commitment to them. The Munkebys engaged Mr. Gill to make the inspection. After inspecting the system, Mr. Gill prepared a report in which he concluded that the septic system was a failing system that did not comply with MPCA rules because it discharged sewage to a drywell. (Exhibit 7) But Mr. Gill also concluded that under MPCA rules the system was working well and did not have to be replaced because it did not present an imminent threat to public health or safety. (Id.)

Minn. Stat. § 115.55, subd. 6 (1996) provides:

**Subd. 6. Disclosure of individual sewage treatment system to buyer.** After August 31, 1994, before signing an agreement to sell or transfer real property, the seller must disclose in writing to the buyer information about the status and location of individual sewage treatment systems on the property or serving the property. The disclosure must be made by delivering to the buyer either a statement by the seller that there is no individual sewage treatment system on or serving the property or a disclosure statement describing the system and indicating the legal description of the property, the county in which the property is located, and a map drawn from available information showing the location of the system on the property to the extent practicable. In the disclosure statement the seller must indicate whether the individual sewage treatment system is in use and, to the seller's knowledge, in compliance with applicable sewage treatment laws and rules. Unless the buyer and seller agree to the contrary in writing before the closing of the sale, a seller who fails to disclose the existence or known status of an individual sewage treatment system at the time of sale, and who knew or had reason to know of the existence or known status of the system, is liable to the buyer for costs relating to bringing the system into compliance with the individual sewage treatment system rules and for reasonable attorney fees for collection of costs from the seller. An action under this subdivision must be commenced within two years after the date on which the buyer closed the purchase of the real property where the system is located.

Although Minn. Stat. § 115.55, subd. 6 (1996) does not come directly into play in this matter, it does shed considerable light on the issues here and indirectly affects the outcome. First, the legal duty of disclosure set forth in the statute is clearly imposed

only on sellers of real property. There is nothing in Minn. Stat. § 115.55, subd. 6 (1996) that requires real estate agents or brokers who may be representing sellers to disclose information about the condition of a septic system on the sellers' property. This does not mean that agents or brokers may not have a duty to disclose; it simply means that such a duty must arise, if at all, from the common law or from the operation of some other statute or rule. Second, Minn. Stat. § 115.55, subd. 6 (1996) expressly requires sellers to disclose whether a septic system is, "to the seller's knowledge, in compliance with applicable sewage treatment laws and rules." In other words, in order to meet the legal duty imposed on them by statute, the Munkebys were clearly obliged to disclose in writing on their private sewer system disclosure statement the fact that their septic system did not comply with MPCA rules because it discharged sewage to a drywell. The Munkebys did not, however, actually commit a violation of Minn. Stat. § 115.55, subd. 6 (1996) because the statute allowed them to make the required disclosure any time "before signing an agreement to sell or transfer real property." Here, the Administrative Law Judge not only found that no written purchase agreement was ever signed by the Munkebys but that no such agreement was ever forwarded to Ms. Engstrom for the Munkebys' signature.<sup>[2]</sup> Moreover, it is uncontroverted that Ms. Engstrom, as the Munkebys' agent, offered to provide Mr. Pyszka with Mr. Gill's written report in its entirety before any purchase agreement was to be signed.<sup>[3]</sup> (Tr. pp. 45, 327)

Although Minn. Stat. § 115.55, subd. 6 (1996) itself imposes no legal duty on real estate salespersons or brokers to disclose the condition of septic systems on the property of sellers they may be representing, the Commissioner, acting under rulemaking authority granted under Minn. Stat. §§ 45.023 and 82.28 (1996), has imposed a legal duty of disclosure on those licensed professionals in Minn. R. pt. 2805.100, subp. 3 (1995):

Subp. 3. **Material facts.** Licensees shall disclose to any prospective purchaser all material facts pertaining to the property, of which the licensee is aware, which could adversely and significantly affect an ordinary purchaser's use or enjoyment of the property, or any intended use of the property of which the licensee is aware.

The primary legal theory underlying Count I in the Third Amended Notice of and Order for Hearing is that Ms. Engstrom breached this duty by failing to disclose to Mr. Pyszka and the Karlsons the condition of the septic system on the Munkebys' property – most specifically, the fact that the septic system did not comply with MPCA rules.<sup>[4]</sup>

In assessing the Department's claim of nondisclosure, the first question that needs to be addressed is whether the septic system's noncompliance was a "material" fact within the meaning of the rule. Minn. Stat. § 115.55, subd. 6 (1996) definitively answers this question. That statute specifically imposes a legal duty on sellers to disclose to prospective buyers whether a septic system is, "to the seller's knowledge, in compliance with applicable sewage treatment laws and rules." In other words, that

statute effectively establishes non-compliance of a septic system with applicable rules as a “material” fact, as a matter of law.<sup>[5]</sup>

Having concluded that the septic system’s noncompliance with MPCA rules was a material fact, the inquiry then turns to whether Ms. Engstrom failed to disclose that fact to Mr. Pyszka, as agent for the buyers. The evidence established that a copy of the Munkebys’ private sewer system disclosure form was faxed to Mr. Pyszka at about 8:31 a.m. on October 11, 1996, and that the disclosure form contained no reference to the septic system’s noncompliance with MPCA rules. (Exhibits A and 8) But the evidence also established that in a voice mail message which Mr. Pyszka received on the previous day – October 10, 1996, Ms. Engstrom orally advised him that Mr. Gill had performed an inspection of the septic system when the Munkebys purchased the property in July of 1996 and indicated that she would be making arrangements to forward to him a copy of Mr. Gill’s report. (Tr. pp. 44, 123, 327) The Department contends that these were the only disclosures Ms. Engstrom made at that time and that they were insufficient to meet her legal duty to disclose material facts. There was credible evidence from the Department’s own witness, however, that Ms. Engstrom also specifically advised Mr. Pyszka in her voice mail message that the Munkebys’ septic system was “nonconforming.” Although Mr. Pyszka may have suggested at one point in his testimony that Ms. Engstrom had told him no more than that Mr. Gill had inspected the septic system and prepared a report (Tr. p. 134), he himself testified elsewhere that she specifically informed him that the septic system was a “nonconforming system.” (Tr. pp. 186, 214-215) The accuracy of this version of Ms. Engstrom’s disclosure is corroborated by written statements made by Mr. Pyszka in support of the complaints he filed with the Minnesota Association of Realtors and the Department.<sup>[6]</sup> In short, a preponderance of the evidence established that on the day before Mr. Pyszka received the Munkebys’ legally inadequate private sewer system disclosure statement, Ms. Engstrom orally advised him that Mr. Gill had conducted an inspection of the septic system, that Mr. Gill’s inspection had revealed that the septic system was “nonconforming,”<sup>[7]</sup> and that she would be forwarding a copy of the report to him so that he and the buyers could evaluate Mr. Gill’s results for themselves. Mr. Pyszka responded to this disclosure by contacting Mr. Gill and obtaining a copy directly from him, rather than waiting to receive a copy of the Gill report from Ms. Engstrom.<sup>[8]</sup>

The essence of the Department’s theory of the case is that the Respondents “intentionally chose to entice people to view the Lakeland home by not disclosing the sewer system problems. The Respondents intended to ‘hook’ prospective buyers on the home, before they told the truth about the sewer system.” (Department’s post-hearing brief, p. 10) In other words, the Department seems to be arguing that the duty of real estate brokers and agents to disclose material facts to prospective buyers requires the former to give the latter notice of a septic system that fails to comply with applicable rules prior to or at the time a prospective buyer inspects a home. A seller’s duty under Minn. Stat. § 115.55, subd. 6 (1996) to disclose the noncomplying status of a septic system is linked by that statute to the act of “signing an agreement to sell or transfer real property.”<sup>[9]</sup> There is nothing in statute, rule, or the common law that suggests that a broker’s or agent’s duty to make the same kind of disclosure must be

discharged earlier, such as when a prospective purchaser inspects the property. In the absence of any authority to the contrary, the timing of a broker's or agent's duty to disclose material facts about a septic system should be considered to be the same as the timing of a seller's.<sup>[10]</sup>

The remaining claims of misconduct on Ms. Engstrom's part that are described in Count I are predicated on the same underlying factual allegations as the claim of nondisclosure of material facts. Minn. Stat. § 82.27, subd. 1 (1996) provides in pertinent part:

Subdivision 1. The commissioner may by order deny, suspend or revoke any license or may censure a licensee if the commissioner finds (1) that the order is in the public interest, and (2) that the applicant or licensee or, in the case of a broker, any officer, director, partner, employee or agent or any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker or closing agent or controlled by the broker or closing agent:

\* \* \*

(b) has engaged in a fraudulent, deceptive, or dishonest practice;

\* \* \*

(f) has, in the conduct of the licensee's affairs under the license, been shown to be incompetent, untrustworthy, or financially irresponsible;

In Minn. R. pt. 2805.2000 (1995), the Commissioner further defined the conduct proscribed by the statute:

Subpart 1. **Prohibitions.** For the purposes of Minnesota Statutes, section 82.27, subdivision 1, clause (b), the following acts and practices constitute fraudulent, deceptive, or dishonest practices:

\* \* \*

I. make any material misrepresentation or permit or allow another to make any material misrepresentation;

J. make any false or misleading statements, or permit or allow another to make any false or misleading statements, of a character likely to influence, persuade, or induce the consummation of a transaction contemplated by Minnesota Statutes, chapter 82;

It is Ms. Engstrom's alleged failure to disclose the condition of the Munkebys' septic system that the Department contends was: a "fraudulent, deceptive, or dishonest practice" within the meaning of Minn. Stat. § 82.27, subd. 1(b); evidence that Ms. Engstrom was "untrustworthy" in the conduct of her affairs within the meaning of Minn. Stat. § 82.27, subd. 1(f); a "material misrepresentation" within the meaning of Minn. R.



pt. 2805.2000, subp. 1.I; and a “false or misleading statement” within the meaning meaning of Minn. R. pt. 2805.2000, subp. 1.J. Having found that Ms. Engstrom did disclose to Mr. Pyszka all material facts relating to the Munkebys’ septic system before the Munkebys even submitted their written private sewer system disclosure statement to him, the Administrative Law Judge concludes that the Department has also failed to establish by a preponderance of the evidence a factual basis for these other claims.

In Count II of the Third Amended Notice of and Order for Hearing and Order to Show Cause, the Department argues that Ms. Engstrom also violated Minn. Stat. § 82.27, subd. 1(b) and (f) (1996) and Minn. R. pt. 2805.2000, subp. 1.I. and J. (1995) by allowing the Munkebys to misrepresent the condition of their septic system on the seller’s property and the private sewer system disclosure statements which they prepared and submitted to Mr. Pyszka. (Exhibits 6 and 8) As noted above, Minn. Stat. § 115.55, subd. 6 (1996) imposed an express duty on the Munkebys, as sellers of real property, to make a written disclosure to prospective buyers of the fact that their septic system did not comply with MPCA rules, but that statute did not expressly impose any such duty on a seller’s agent, such as a real estate salesperson or broker. If Ms. Engstrom is therefore to be held vicariously liable for what the Munkebys failed to state on those disclosure statements, it must be on the basis of some other law or principle of law.

First of all, an agent is not liable because of the misrepresentations of his or her principal unless the agent knows or should know of them. 3 C.J.S. Agency § 382 (1973); Restatement (Second) of Agency § 348, Comment b. (1958); Hunt Trust Estate v. Kiker, 269 N.W.2d 377, 380 (N.D. 1978). The language in Minn. R. pt. 2805.2000, subp. 1.I. and J. (1995) relating to a licensed person “allowing or permitting” another person to make any material misrepresentation or false or misleading statement must be read as incorporating this requirement of knowledge. There was no evidence in the record suggesting that Ms. Engstrom had counseled the Munkebys to refrain from disclosing on their property and private sewer system disclosure statements the fact that their septic system did not comply with applicable rules. Rather, the testimony established that Ms. Engstrom told the Munkebys to complete the disclosure statements “to the best of their knowledge” and that she was not physically present when the Munkebys subsequently completed the forms. (Tr. pp. 47, 54-56) The evidence also established that Ms. Engstrom did not have an opportunity to see the disclosure statements before they were faxed to Mr. Pyszka. To the contrary, Mr. Munkeby testified that after he and his wife completed the private sewer system disclosure statement on October 11, 1996, he either faxed it directly to Mr. Pyszka or to Ms. Engstrom’s assistant who, in turn, faxed it to Mr. Pyszka. (Tr. p. 93) In short, the Department failed to prove by a preponderance of the evidence that Ms. Engstrom had knowledge of any omissions of material fact on the disclosure statements which the Munkebys submitted to Mr. Pyszka. There is also the matter of Ms. Engstrom’s oral disclosure of the noncompliant status of the septic system in her voice mail message to Mr. Pyszka on October 10th. The Administrative Law Judge can find no principle of law holding an agent vicariously liable for a fraudulent or negligent failure by the agent’s

principal to disclose a material fact to a third party where the agent has, in fact, made a prior, independent disclosure of that material fact to the same third party.

Finally, in Count III the Department asserts that by allowing Ms. Engstrom to conduct herself in the ways alleged, Burnet failed to exercise reasonable supervision over her in violation of Minnesota statutes and rules. Minn. Stat. § 82.27, subd. 1 (1996) also provides in pertinent part:

Subdivision 1. The commissioner may by order deny, suspend or revoke any license or may censure a licensee if the commissioner finds (1) that the order is in the public interest, and (2) that the applicant or licensee or, in the case of a broker, any officer, director, partner, employee or agent or any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker or closing agent or controlled by the broker or closing agent:

\* \* \*

(d) has failed to reasonably supervise brokers, salespersons, or closing agents so as to cause injury or harm to the public;

Having found, however, that Ms. Engstrom personally disclosed all material facts concerning the condition of the Munkebys' septic system and, therefore, did not breach any legal duty imposed on her by applicable statutes or rules, there is no basis in fact or law for concluding that Burnet breached its statutory duty to provide reasonable supervision of its affiliated salespersons.

B. H. J.

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<sup>[1]</sup> This finding relates to lost testimony of Thomas L. Rehman about which the parties were unable to agree and stipulate. It is made at the request of the parties.

<sup>[2]</sup> Mr. Pyszka testified that he prepared a written purchase agreement and had the Karlsons sign it on October 10, 1996. (Tr. p. 138-139) He conceded, however, that he did not forward the original of that purchase agreement to Ms. Engstrom for the Munkebys' signatures because the original was still in his own file at the time of the hearing. (Tr. pp. 167-175) Mr. Pyszka did testify that he faxed a copy of a written purchase agreement to Ms. Engstrom at her office on October 10th. (Tr. p. 140) Ms. Engstrom, on the other hand, testified that she never received such a fax and, further, that in a telephone conversation with Mr. Pyszka she indicated that any negotiations would have to be oral until after the weekend because she was preoccupied with her daughter's wedding. (Tr. pp. 43-44) The Administrative Law Judge accepted Ms. Engstrom's account because, among other things, Mr. Pyszka was unable to produce a fax cover sheet documenting his fax transmission of a written purchase agreement to Ms. Engstrom when cover sheets were available to document other key fax transmissions made by him. (See Exhibits 15 and 16) Additionally, there was nothing on Exhibit J to indicate that it had been faxed.

<sup>[3]</sup> Ms. Engstrom ultimately did not provide Mr. Pyszka with a copy of the Gill report, but both parties agreed that was only because Mr. Pyszka had already obtained a copy from another source. (Tr. pp. 53, 135)

<sup>[4]</sup> Both at the hearing and in its post-hearing brief, the Department also suggested that a finding by Mr. Gill that "the liquid level of the septic tank appears to be quite high indicating possible baffle problems"

may also have been a material fact requiring disclosure. (Exhibits 7 and D) But because of the equivocal nature of Mr. Gill's statement, taken together with his conclusion that no immediate corrective action was required, the Administrative Law Judge concluded that possible baffle problems could not "adversely and significantly affect an ordinary purchaser's use or enjoyment of the property, or any intended use of the property." Minn. R. pt. 2805.100, subp. 3 (1995)

[5] At the hearing, Mr. Munkeby took the position that noncompliance with MPCA rules was not a "defect" within the meaning of line 50 of the private sewer system disclosure statement because the system was performing adequately and MPCA rules did not require that any corrective action be taken to repair or replace the septic system. But Mr. Munkeby's subjective belief cannot alter the express requirements and intent of Minn. Stat. § 115.55, subd. 6 (1996).

[6] In both complaints (Exhibits G and 10), the terms of which were identical, Mr. Pyszka made the following statements:

Prior to receiving the disclosure form from Becky I received a voice mail message from her. This message indicated to me that the system was working fine with no problems and was only a nonconforming system. She told me that Jack Gill did the original test with these findings. [Emphasis supplied.]

[7] There was no contention that describing the septic system as "nonconforming" amounted to an ambiguous disclosure. Mr. Pyszka and other Edina agents had considerable training and experience relating to private sewer system disclosures. (Tr. pp. 196-197, 220-222) He testified on cross examination that he understood Ms. Engstrom's statement that the septic system was "nonconforming" to mean that it did not comply with applicable statutes and rules. (Tr. pp. 214--215)

[8] What is curious is that Edina agent Katie Daniels had represented the sellers when the Munkebys purchased the property in July of 1996. Ms. Daniels had a copy of the Gill report in her file. (Tr. p. 226) Although Mr. Pyszka testified that he discussed the issue of the septic system with Ms. Daniels (Tr. p. 184), she apparently did not provide him with her copy of the Gill report.

[9] Even assuming that the Administrative Law Judge had found, as a fact, that some sort of purchase agreement had been entered into between the Munkebys and the Karlsons on October 10, 1996, the Department failed to establish by a preponderance of the evidence that Ms. Engstrom's voice mail disclosure to Mr. Pyszka followed, rather than preceded, consummation of such an agreement.

[10] There was conflicting evidence about the Department's position regarding when disclosure of material facts, including those relating to septic systems, should be made. (Compare Exhibit I with Tr. pp. 335-352) That particular subject has not specifically been addressed in the Department's rules. If the Commissioner wishes to impose an earlier or more stringent duty to disclose material facts about septic systems on brokers and agents, he presumably can do so by rulemaking.